

Special Publication nr. 13. - Abstract

Retail payment intermediation from the standpoint of contingency and financial stability

Central Bank of Iceland

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In September 2018, the Central Bank of Iceland published a special report on *Retail payment intermediation from the standpoint of contingency and financial stability*. The report is organised into five chapters and an appendix containing terms and definitions. Chapter 1 focuses on the Central Bank of Iceland's role in the field of payment intermediation, as the Bank is required by law to carry out tasks consistent with its role as a central bank, including *promoting a sound and efficient financial system, including domestic and cross-border payment systems*; cf. Article 4, Paragraph 2 of the Act on the Central Bank of Iceland, no. 36/2001. The report is an element in fulfilling the Bank's obligations in this regard. It centres on retail payment intermediation and the fact that modern consumers and companies depend on effective electronic payment instruments.

The report covers the past several years' developments in electronic payment intermediation and the reduction in use of cash, particularly in the Nordic countries. The needs and requirements of consumers and companies go hand-in-hand with technological advances. Internet and smart device use has become very widespread, and it affects expectations concerning execution time, access, and simplicity or convenience. Alongside these developments, awareness has grown among market agents and governmental authorities of the inevitable risks involved and the necessity of maintaining appropriate security, risk management, and contingency measures. Like any other service based on the operation of information systems, payment intermediation can be interrupted without notice, and for a variety of reasons. Any number of factors may be involved: natural disasters, technological malfunctions, bugs, cyberattacks, etc. Mapping out important infrastructure and entities is therefore essential at any time. It is important that market agents, governmental authorities, and the general public engage in discourse on the provision of payment services or retail payment intermediation, particularly as regards operational continuity and contingency as they relate to the effectiveness of important electronic payment instruments.

The Central Bank takes the view that the statutory provision instructing it to promote sound and efficient payment systems entails, among other things, promoting consensus among market agents and the authorities as regards contingency measures for retail payment intermediation in cases of emergency; i.e., in the event of a severe interruption in service or the threat of such interruption.

Chapter 2 of the report briefly covers the reasons for its having been compiled, and Chapter 3 contains a general discussion of retail payment intermediation or payment services (as distinct from interbank payment intermediation). It describes the importance of electronic payment intermediation in Iceland, as the largest systems are part of the technological environment of a single entity, the Icelandic Banks' Data Centre (RB), which is unequivocally the most important technological service provider in the Icelandic financial system for both interbank and retail payment intermediation.

Chapter 4 of the report covers the security and effectiveness of domestic retail payment intermediation. The chapter states, among other things, that provision of payment services is based

on the effectiveness of the information systems involved in settlement. As complexity in the payment intermediation chain has increased with technological advances and a changing regulatory framework, market agents and governmental authorities have grown more aware of the inevitable risks and appropriate security requirements. It is necessary to make regular assessments of whether the institutional and legal environment is well enough prepared to ensure effective retail payment intermediation during an emergency, as service could be interrupted for a variety of reasons.

The financial crisis of autumn 2008, which severely tested the retail payment intermediation framework, is discussed briefly. As is well known, the commercial banks failed, and Icelandic society, which was heavily reliant on electronic payment intermediation, found itself in unprecedented circumstances. Payment card conglomerates VISA and MasterCard resorted to various measures that caused problems, but the Central Bank responded in a variety of ways, with reference to its statutory obligation to promote sound and efficient payment systems in Iceland, as is discussed further in this chapter of the publication. Although efforts to keep electronic payment intermediation running were effective, and while households and businesses were barely aware of any hiccups or interruptions in the operations of the most important electronic payment instruments in cash transactions (i.e., debit and credit cards), a number of fundamental questions came to the fore at the time, as regards the possible application of governmental powers in order to ensure continued retail payment intermediation operations in Iceland under exceptional circumstances.

The report states that until now, and based on experience from the financial crisis, the Central Bank has taken the view that domestic debit cards were the tool the authorities could use if action should be needed to ensure continued operability of electronic retail payment intermediation during any type of crisis. At the time of the crisis, the general understanding was that clearing and settlement of debit card payments was entirely in the hands of domestic entities — i.e., within Icelandic jurisdiction — and there was no risk of external intervention in the settlement process for domestic debit card transactions, in contrast to the card conglomerates' actions pertaining to credit cards. The premises for that conclusion may have weakened in recent years, however, with changes in the card market.

At a time of rapid growth in payment intermediation, when it is growing steadily easier to provide cross-border financial services, it is unavoidable to demand clear and unequivocal ground rules, although the principles of proportionality and non-discrimination must be observed. From the standpoint of the public interest, in a modern society where consumers and employers rely on effective electronic payment intermediation, the Bank considers it inevitable to identify one or more realistic alternative solutions that can be used in case of a major interruption in operation of important electronic mediums of payment. Otherwise, it will not be possible to guarantee secure, efficient domestic retail payment intermediation. In this context, the following is specified:

- It is vital to ensure consensus among payment instrument issuers, acquirers and other types of payment service providers, and governmental authorities on the identification, design, and use of such alternative solutions at any given time.
- The Central Bank's inventory of banknotes at any given time is an element in the financial system's preparedness for major interruptions in service and/or financial crises.
- Future mobile device solutions and/or electronic krónur (rafkrónur)¹ issued by the Central Bank could also function as alternates in this sense.

¹Concurrent with the summary under discussion here, the Central Bank is also issuing an interim report entitled *Rafkróna (Electronic krónur)?* (Central Bank of Iceland *Special Publication* no. 12).

Chapter 5 of the report describes the Central Bank's position in greater detail and presents proposals for the next steps. The summary emphasises how important it is that the Icelandic authorities have effective tools in the form of one or more alternative domestic retail payment intermediation options at their disposal at all times, and that such tools can realistically be activated at short notice. In the Bank's opinion, anything else is unacceptable for a society like Iceland's, which relies heavily on electronic payment intermediation. Furthermore, the retail payment intermediation alternatives must be reviewed regularly, and it is desirable to retain the consensus among market agents and governmental authorities.

As is mentioned above, the publication includes an appendix containing terms and definitions.